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## CITATIONS



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Statutes:

# In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 405

UNITED STATES OF AMERICA, PETITIONER

*v.*

PIONEER AMERICAN INSURANCE COMPANY, ET AL.

*ON WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF ARKANSAS*

## BRIEF FOR THE UNITED STATES

### OPINIONS BELOW

The decree of the Chancery Court of Sebastian County, Arkansas (R. 35–48) is not reported. The opinion of the Supreme Court of Arkansas (R. 72–77) is reported at 235 Ark. 267, 357 S.W. 2d 653. The dissenting opinion of Chief Justice Harris, inadvertently omitted from the printed record, is set forth in Appendix A, *infra*, pp. 23–26.

### JURISDICTION

The judgment of the Supreme Court of the State of Arkansas was entered on June 4, 1962 (R. 77–78). The petition for a writ of certiorari was filed on September 4, 1962, and was granted on November

19, 1962 (R. 78; 371 U.S. 909). The jurisdiction of this Court rests on 28 U.S.C. 1257(3).

## QUESTION PRESENTED

Whether federal tax liens are entitled to priority over the claim of a mortgagee for an attorney's fee incurred in prosecuting a foreclosure suit where notice of the federal tax liens was recorded prior to the entry of the judicial decree which allowed and determined the amount of the fee.

## STATUTES INVOLVED

Sections 6321, 6322 and 6323 of the Internal Revenue Code of 1954 and Sections 68–101, 68–102 and 68–910 of the Arkansas Statutes are set forth in Appendix B, *infra*, pp. 27–29.

## STATEMENT

In 1958, the taxpayers (Ocie A. Rogers and Florence W. Rogers, his wife) purchased a parcel of real property in Sebastian County, Arkansas, assuming liability on a note, secured by a mortgage, held by respondent Pioneer American Insurance Company ("Pioneer") (R. 72). In the note the maker agreed—

> in the event of default herein and of the placing of this note in the hands of an attorney for collection, or this note is collected through any court proceedings, to pay a reasonable attorney's fee [R. 7].

The mortgage provided that if the grantor should fail to pay any interest or installment of principal when due, then, at the option of the holder, all of the

indebtedness secured by the mortgage would become due and the mortgage could be foreclosed (R. 13, 72).

Taxpayers defaulted on the monthly payment due in October 1960, and on all subsequent payments (R. 73). On March 24, 1961, Pioneer filed a suit to foreclose its mortgage, and sought a reasonable attorney's fee (R. 1–6). The United States was named a party defendant because of two outstanding liens for federal taxes assessed against the taxpayers, notice of one having been filed on November 29, 1960, and of the other on January 30, 1961 (R. 4–5, 73). In its answer (R. 20–21) the United States admitted that its liens for taxes were subordinate to the lien of the mortgagee to the extent of principal and interest, but asserted that its liens were superior to the lien of the mortgagee for an attorney's fee. On November 9, 1961, the United States amended its answer to include three additional tax liens that had been filed on April 14, July 17, and October 3, 1961 (R. 34, 73).[1]

On November 15, 1961, the Chancery Court of Sebastian County entered a decree of foreclosure (R. 35–48) which fixed an attorney's fee of $1,250 (R.

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[1] The amounts of the tax liens were as follows (R. 73):

| | |
|---|---|
| November 29, 1960 | $1,776.65 |
| January 30, 1961 | 1,567.14 |
| April 14, 1961 | 1,288.96 |
| July 17, 1961 | 1,606.87 |
| October 3, 1961 | 1,148.69 |

As of November 15, 1961, when the Chancery Court entered its decree, the total amount due on all the tax liens, including interest and filing fees, was $6,482.66 (R. 41, 44, 64). See note 3, *infra*.

43, 45) and determined priority between Pioneer and the United States as follows (R. 42).

> The lien of United States of America is therefore found to be subordinate to the lien of plaintiff, Pioneer American Insurance Company, (for all amounts it secures, including principal of the note and interest thereon; * * * and attorney's fees fixed by the Court) * * *[2]

The effect of this ruling was to give the United States $1,250 less on its tax claims than it would have received had those claims been given priority over the attorney's fee.

In accordance with the foreclosure decree, the mortgaged property was sold, and with the consent of the United States, Pioneer received the balaiffe of its principal and all interest due to the date of such payment.[3] The sum of $3,822.38, however, has been retained by the Chancery Court to await the result

[2] The United States had also admitted that its liens were junior to a second mortgage on the property held by The Development Company, Inc., and the court held, in a ruling not challenged on appeal, that a mechanics lien held by Alfred J. Anderson was also senior to the tax liens. (R. 39–40.)

[3] The proceeds of the sale plus rents paid during the foreclosure proceedings amounted to $25,411.67. (R. 51.) The costs of sale were $257.55, leaving a balance of $25,154.12 which the court directed to be distributed as follows (R. 51–52):

| | |
|---|---|
| Pioneer American Insurance Company: Principal and interest | $18,764.33 |
| Bethel & Pearce, attorneys for Pioneer | 1,250.00 |
| The Development Company, Inc | 2,064.93 |
| Alfred J. Anderson | 207.18 |
| Remainder to the United States | 2,867.38 |

of this litigation. Of this amount, $2,572.18 are funds of the United States, and the balance ($1,250) represents the amount in controversy. (R. 49, Appendix C, pp. 30–31.)[4]

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[4] The federal tax liens, as of the date of the order of distribution, were as follows (R. 64–65):

| | |
|---|---|
| Lien of November 29, 1960 | $659.67 |
| Lien of January 30, 1961 | 1,661.03 |
| Lien of April 14, 1961 | 1,344.69 |
| Lien of July 17, 1961 | 1,653.23 |
| Lien of October 3, 1961 | 1,164.04 |

Under the priorities fixed by the Chancery Court, the first two federal liens, amounting to $2,320.70, would be paid in full and $546.68 would be available for partial payment of the third lien of $1,344.69. If the federal liens are given priority over the attorney's fee, an additional $1,250.00 would be available for distribution to the United States. This sum would satisfy the remaining $798.01 due in the third lien, plus a portion of the fourth lien. At the same time, $1,250.00 less would be available for distribution to the prior claimants. If the Chancery Court granted the same priorities to Pioneer Development Company and Anderson that it applied in the present case—and their relative priorities vis-a-vis each other is a matter of State law—Pioneer would receive its entire claim for principal and interest, together with $1,250.00 for the attorney's fee; Development Company would receive $1,022.14 on its claim for $2,064.93 under the second mortgage; and Anderson would receive nothing on his mechanics' lien claim of $207.18.

If the Court accepts our argument that the federal liens have priority over the attorney's fee, the foregoing figures may have to be adjusted to reflect the interest that has accrued on the federal tax claims since the entry of the foreclosure decree in November 1961.

While the decree provided for the payment of the attorney's fee (R. 53–55), the supersedeas bond filed in connection with

On appeal by the United States, the Supreme Court of Arkansas (Chief Justice Harris dissenting) affirmed the decree of the Chancery Court (R. 72–78; App. A, *infra*, pp. 23–26).

## SUMMARY OF ARGUMENT

A. Under the Internal Revenue Code, the United States has a perfected, choate lien against all property of the taxpayer. The lien arises when the tax is assessed, but it is not valid against mortgagees until it has been recorded. The federal lien has priority over a prior State-created lien unless the latter, too, is choate. For a State-created lien to be "choate" in the federal sense so that it has priority over a federal lien, "the amount of the lien [must be] established." *United States* v. *New Britain*, 347 U.S. 81, 84.

Pioneer's lien for attorney's fees incurred in foreclosing the mortgage was not a choate or perfected lien at the time the federal tax liens arose and therefore was not entitled to priority over them. The note, secured by the mortgage, did not obligate the maker to pay any specific amount as an attorney's fee, but merely to pay a reasonable fee in the event of default and the institution of proceedings for collection (R. 7). The amount of any such fee could not be established until it was fixed by a court decree;

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the appeal to the Supreme Court of Arkansas shows that the Chancery Court has retained the $1,250.00 representing such fee. A copy of the bond is set forth in Appendix C, *infra*, pp. 30–31.

and that did not take place until the Chancery Court entered its foreclosure decree on November 15, 1961, which was subsequent to the date on which the last of the federal tax liens had been recorded (October 3, 1961).

B. The fact that Arkansas permits provisions in promissory notes for the payment of attorneys' fees to be enforced as contracts of indemnity does not justify giving liens for such fees priority over earlier-perfected federal tax liens. The mere act of default did not entitle the maker to an attorney's fee: he became entitled to a fee only if collection proceedings were instituted, and then only in such amount as the court fixed. Pioneer could enforce its claims for attorney's fees only as a contract of indemnity, and it was not entitled to indemnity until the amount of the attorney's fee had been determined. When this took place on November 15, 1961, the federal liens had already been perfected, and they could not be displaced by the subsequently perfected State-created lien.

C. Nor can attorneys' fees be given priority as an expense of foreclosure on the theory that the attorneys were responsible for creating the fund out of which the competing claims were satisfied. First, the services of the attorneys in conducting the foreclosure proceedings did not create a "fund" in the sense that attorneys do when they successfully prosecute and recover judgment on a claim for damages; the attorneys did not bring into existence any new asset, but

merely changed from real property to money the form of the asset from which the claims were to be satisfied. Second, the services were all performed at the behest of, and for the benefit of, the mortgagee, in order to protect its financial interest in the property, which was adverse to that of the United States. The suggestion of the Supreme Court of Arkansas that the attorney's fee should be given priority over the federal tax lien because otherwise the payment of such fee by Pioneer will deny it its full claim, is fully answered by this Court's recent decision in *United States* v. *Buffalo Savings Bank*, No. 96, this Term, decided January 7, 1963. There the Court rejected a similar argument in holding that a State cannot give local real estate taxes priority over a federal tax lien by treating them as expenses of sale incurred in the foreclosure of a mortgage which was concededly senior to the federal lien.

## ARGUMENT

### A FEDERAL TAX LIEN HAS PRIORITY OVER A MORTGAGEE'S LIEN FOR AN ATTORNEY'S FEE, NOT FIXED IN AMOUNT UNTIL AFTER THE FEDERAL LIEN WAS PERFECTED, WHICH WAS INCURRED IN FORECLOSING A MORTGAGE PRIOR TO THE FEDERAL LIEN

The Supreme Court of Arkansas held that an attorney's fee which is awarded to a mortgagee by a decree in a mortgage foreclosure suit is entitled, as part of the mortgage debt, to priority of payment over federal tax liens which arose and were perfected prior to the decree. This ruling is contrary

to the settled principles governing the relative priority between federal tax liens and State-created liens, because it permits an inchoate State lien to rank ahead of a perfected federal lien.

A. THE LIEN FOR AN ATTORNEY'S FEE WAS NOT PERFECTED UNTIL THE FEE WAS AWARDED AND FIXED BY THE CHANCERY COURT, AND THE EARLIER-PERFECTED FEDERAL LIEN THEREFORE HAS PRIORITY

The principles governing the priority of federal tax liens have been frequently stated by this Court, and need not be repeated at length. In brief, the Internal Revenue Code gives the United States a lien for unpaid taxes upon "all property and rights to property, whether real or personal" of the taxpayer; the lien arises when the assessment is made; but it is not valid against mortgagees, pledgees, purchasers or judgment creditors until it has been recorded (Sections 6321, 6322 and 6323 of the Internal Revenue Code of 1954, *infra*, pp. 27-28). The federal tax lien, although general, is a perfected, choate lien as soon as it arises, and it cannot be defeated by a prior state-created lien unless the latter, too, is choate. Since

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[5] *Spokane County* v. *United States*, 279 U.S. 80; *New York* v. *Maclay*, 288 U.S. 290; *United States* v. *Waddill Co.*, 323 U.S. 353; *Illinois* v. *Campbell*, 329 U.S. 362; *United States* v. *Security Trust & Sav. Bank*, 340 U.S. 47; *United States* v. *New Britain*, 347 U.S. 81; *United States* v. *Aeri*, 348 U.S. 211; *United States* v. *Liverpool & London Ins. Co.*, 348 U.S. 215; *United States* v. *Scovil*, 348 U.S. 218; *United States* v. *Colotta*, 350 U.S. 808, reversing *per curiam*, 224 Miss. 33, 79 S. 2d 474; *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010, reversing *per curiam*, 227 F. 2d 359 (C.A. 7); *United States* v.

the priority of a federal lien is always a federal question, this Court is not bound by a State court's characterization of a State lien as perfected.[6] If the federal and State liens are both choate, then their priority is determined by the rule that "the first in time is the first in right";[7] but if the earlier State lien is inchoate, the subsequent federal lien has priority.[8] The subsequently-perfected State lien cannot be "related back" to the time of its creation to defeat the federal lien.[9]

For a State-created lien to be "choate" in the federal sense so that it has priority over a federal lien, three conditions must be satisfied: "[1] the identity of the lienor, [2] the property subject to the lien, and [3] the amount of the lien [must be] established." *United States* v. *New Britain*, 347 U.S. 81, 84; see *Illinois* v. *Campbell*, 329 U.S. 362, 375. All three of these requirements must be met before the lien is perfected; the failure in any one respect makes

*Vorreiter*, 355 U.S. 15, reversing *per curiam*, 134 Colo. 543, 307 P. 2d 475; *United States* v. *Ball Construction Co.*, 355 U.S. 587, reversing *per curiam*, 239 F. 2d 384 (C.A. 5); *United States* v. *Hulley*, 358 U.S. 66, reversing *per curiam*, 102 S. 2d 599 (Fla.); *United States* v. *Buffalo Savings Bank*, No. 96, this Term, decided January 7, 1963; cf. *Crest Finance Co.* v. *United States*, 368 U.S. 347.

[6] *United States* v. *Security Trust & Sav. Bank*, 340 U.S. 47, 49; *United States* v. *Gilbert Associates*, 345 U.S. 361; *United States* v. *Acri*, 348 U.S. 211, 213.

[7] *United States* v. *New Britain*, 347 U.S. 81, 85–86.

[8] See the cases cited note 5, *supra*.

[9] *United States* v. *Security Trust & Sav. Bank*, 340 U.S. 47, 50

the State lien junior to the federal lien. *Illinois* v. *Campbell, supra.*

Under these settled principles, Pioneer's lien for attorney's fees incurred in foreclosing the mortgage plainly was not a choate or perfected lien at the time the federal tax liens arose, and it was therefore not entitled to priority over them. When the federal liens arose, the amount of the lien for attorney's fees was not established. On the contrary, "the fact and the amount of the lien were contingent upon" the possible future initiation of a foreclosure action and "upon the outcome of [such] suit" (*United States* v. *Acri*, 348, U.S. 211, 214).

The note, secured by the mortgage, did not obligate the maker to pay any specific amount as an attorney's fee, but merely to pay a "reasonable" fee in the event of default and the institution of proceedings for collection (R. 7). The amount of such fee, if any, could and would not be established until it was fixed by a court decree; and that did not take place until the Chancery Court entered its foreclosure decree on November 15, 1961, which was subsequent to the date on which the last of the federal tax liens had been recorded (October 3, 1961; see note 1, *supra*). Thus, the lien for the attorney's fee was not choate, in the federal sense, at the time the federal liens arose and were filed; and the federal liens therefore had priority over the subsequently-perfected lien for the attorney's fee.

The majority of the federal courts (including the two courts of appeals which have decided the ques-

tion), as well as various State courts, have upheld the priority of a federal tax lien over a lien for an attorney's fee, not fixed until after the federal lien was perfected, which was incurred in foreclosing a mortgage prior to the federal lien. *United States* v. *Bond*, 279 F. 2d 837 (C.A. 4), certiorari denied, 364 U.S. 895; *In re New Haven Clock & Watch Co.*, 253 F. 2d 577 (C.A. 2); *United States* v. *Ringler*, 166 F. Supp. 544 (N.D. Ohio); *United States* v. *Lorton* (E.D. Ill.), decided December 14, 1961 (1962-1 U.S.T.C., par. 9490); *First State Bank of Medford* v. *United States*, 166 F. Supp. 204 (D. Minn.); *Bank of America* v. *Embry*, 188 Cal. App. 2d 425, 10 Cal. Rptr. 602; and see *American Surety Co.* v. *Sunkberg*, 58 Wash. 2d 337, 363 P. 2d 99, certiorari denied, 368 U.S. 989.[10] As the court explained in *Bond*, in words that are equally applicable to the present case (279 F. 2d at 846):

> The fee was incurred long after the attachment of the federal tax lien; and at the time of the execution of the mortgage and the creation of the debt secured thereby, the future existence or amount of such attorney fee was, at best, speculative and uncertain.

[10] Contra: *Streeter Brothers* v. *Overfelt*, 202 F. Supp. 143 (D. Mont.); *Western Montana Building & Loan Assn.* v. *Johnson*, unreported (D. Mont.), pending on appeal, C.A. 9, No. 18023; *Lumbermen's Underwriting Alliance* v. *Fall Creek Box & Manufacturing Co.* (D. Ore.), decided October 16, 1962 (1962-2 U.S.T.C., par. 9795). The proceedings before the Ninth Circuit in the *Johnson* case have been stayed pending the outcome in the present case. There have also been several unreported State trial court decisions which have given the attorney's fee priority over the federal lien.

The Supreme Court of Arkansas apparently relied on *Security Mortgage Co. v. Powers*, 278 U.S. 149, as indicating that the lien for attorneys' fees became choate prior to the perfection of the federal liens (R. 75). The *Powers* case does not so indicate. It did not involve the priority of a federal tax lien at all. The question there was whether a mortgagee's claim for an attorney's fee of ten percent, provided for in the note which the mortgage secured, could be enforced in the bankruptcy proceedings against the proceeds of the sale of the mortgaged property. This Court, in reversing the lower courts' disallowance of the claim, ruled (1) that the validity of the lien claimed by the mortgagee for attorney's fees "must be determined" by State law (p. 153); that the enforcibility of the liability for attorney's fees against the proceeds of the sale raised "federal questions peculiar to the law of bankruptcy" (p. 154); and that nothing in the Bankruptcy Act barred enforcement of the claim (pp. 155–160). In rejecting the view, which certain lower federal courts had adopted, that the liability could not be enforced because it was contingent at the time of the adjudication in bankruptcy, the Court stated (p. 156):

> We find nothing in the Bankruptcy Act to justify such a refusal. The lien was not inchoate at the time of the adjudication. It had already become perfect when the principal note and the loan deed securing it were given. Property subject to a lien to secure a liability still contingent at the time of bankruptcy is not discharged from the lien by the adjudication.

> * * * When by the happening of the event the contingent liability becomes absolute, the lien becomes enforceable though this occurs after the adjudication. [Footnote omitted.]

The statement that the lien for attorney's fees "had already become perfect when the principal note and the loan deed securing it were given" must be read in the light of the question before the Court, namely, whether the enforcement of the claim for attorney's fees against the proceeds of the sale of the mortgaged property was barred by the Bankruptcy Act. As we read the opinion, the Court ruled only that, either as a matter of State law or of federal bankruptcy law, the lien for attorney's fees, though contingent, was not inchoate at the time of the adjudication in bankruptcy. The Court recognized that the liability represented by the promise to pay attorney's fees was "still contingent at the time of bankruptcy" but subsequently became "absolute" and "enforceable." *Powers* was decided before this Court developed the doctrine of the choate lien for federal tax purposes (see note 5, *supra*, pp. 9–10). The statement in *Powers* with respect to the choateness of a contingent lien in bankruptcy cannot be read as qualifying the long line of subsequent decisions in which this Court held that a State-created lien is not choate, as against the federal tax lien, until its amount has been fixed.

B. THE FACT THAT ARKANSAS TREATS PROVISIONS IN PROMISSORY NOTES TO PAY ATTORNEYS' FEES AS CONTRACTS OF INDEMNITY DOES NOT JUSTIFY GIVING LIENS FOR SUCH FEES PRIORITY OVER FEDERAL TAX LIENS

The Supreme Court of Arkansas, relying on the fact that under Arkansas law[11] a provision in a promissory note for the payment of an attorney's fee is enforcible as a contract of indemnity, ruled that when the first default in payment took place in October, 1960, the holder of the note could immediately enforce the contract of indemnity; and that since such default occurred prior to the filing of the first federal tax lien notice on November 29, 1960, "the right for attorney's fee became choate before the United States Government filed its lien claim" (R. 75–76). As we have already shown, however, the lien for the attorney's fee did not become choate under federal law until the amount of the fee was fixed by the decree of the Chancery Court on November 15, 1961, which was after the last federal lien had been perfected. Moreover, as Chief Justice Harris pointed out in his dissenting opinion (App. A, *infra*, p. 25, emphasis in original), the question

> is not when the company became entitled to enforce the provision for an attorney's fee, but rather, when it actually did enforce it. I emphatically disagree with the statement of the Majority, for I cannot see that the company was due to add the attorney's fee *immediately upon default*. Debtors frequently are a few

[11] Section 68–910, Arkansas Statutes, Annotated, App. B, *infra*, p. 29.

days late in making payments, but no one would contend that this permits a note holder to add an attorney's fee. The default in payments on this note occurred in October, but I daresay that if Rogers had subsequently made the October payment, and the other payments, no foreclosure suit would have been filed. Certainly, if delinquent payments had been made and accepted by the company, it would not be contended that Pioneer should be permitted to add an attorney's fee. In such event, there would have been no occasion to enforce any contract for indemnity, for there would have been no loss.

Furthermore, as Justice Harris also noted (*id.*, p. 25), the "claim for attorney's fee can only be enforced by court action." See *First State Bank of Medford* v. *United States*, 166 F. Supp. 204 (D. Minn.). The Arkansas statute validates a provision in a promissory note for the payment of an attorney's fee, not to exceed ten percent of the principal due (plus accrued interest), "for services actually rendered in accordance with its terms."[12] The note in the present case calls for payment of "a reasonable attorney's fee" in the event of default and of "the placing of this note in the hands of an attorney for collection, or this note is collected through any court

[12] Prior to the enactment of this statute in 1951, Arkansas law treated provisions in notes, mortgages and deeds of trust for the payment of attorney's fees as unenforcible penalty provisions. See *Boozer* v. *Anderson*, 42 Ark. 167; *Arden Lumber Co.* v. *Henderson Iron Works & Supply Co.*, 83 Ark. 240, 103 S.W. 185; see, also, *Holloway* v. *Pocahontas Federal Savings & Loan Assn.*, 230 Ark. 310, 323 S.W. 2d 204.

proceedings" (R. 7). Thus, a default itself would not obligate the maker to pay an attorney's fee; the obligation only arose if thereafter an attorney was retained to collect the note, and then only to the extent of a reasonable fee for the services actually rendered.

Pioneer could enforce the obligation to pay an attorney's fee only as a contract of indemnity. But the amount of indemnity, if any, to which Pioneer would be entitled could not be determined until after default, (1) an attorney had been retained, and (2) the amount of his fee had been finally fixed by the court. Neither of these conditions had been met when the default occurred in October, 1960. While the filing of the foreclosure suit on March 24, 1961, satisfied the first condition, the second condition was not satisfied until almost eight months later, when the Chancery Court on November 15, 1961, finally fixed the attorney's fee at $1250.00. As of the latter date, as we have noted, the federal liens had already been perfected, and they could not be displaced by the subsequently-perfected State-created lien.

C. THE ATTORNEY'S FEE IS NOT ENTITLED TO PRIORITY OVER THE FEDERAL LIEN AS AN EXPENSE OF FORECLOSURE.

The Supreme Court of Arkansas gave another ground for awarding the attorney's fee priority over the federal tax lien: Since the attorneys' "efforts brought the money into Court," it "would violate the rules against unjust enrichment" to allow the United States "to assert a claim superior to the payment of the fee that Pioneer has paid to cause the mortgaged

property to be reduced to cash and the proceeds readied for distribution, as they now are" (R. 77). But to frame the issue in terms of unjust enrichment assumes the answer. If, as we contend, the federal lien has priority, no unjust enrichment of the United States results from recognizing such priority. The real inquiry on this point, we believe, is whether the attorney's fee may properly be treated as an expense of foreclosure on the theory that the attorneys were responsible for creating the fund out of which the competing claims are to be satisfied. We think the answer is clearly negative.

First, the services of the attorneys in instituting and conducting the foreclosure proceedings did not create a "fund" in the sense that attorneys do when they successfully prosecute and recover judgment on a contested claim for damages. In the latter situation the attorneys bring into being an asset that, were it not for their services, would never have existed.[11] In the present case, however, all the attorneys did was to liquidate and convert into money the security for the debt; the foreclosure proceedings merely changed from real property to money the form of the assets out of which the claim would be paid. There is no indication, or even suggestion, that the attorneys' services in any way increased the total amount available for distribution. Cf. *Southern Railway Co.* v. *United States*, 306 F. 2d 119 (C.A. 5).

[11] There is no occasion to consider or decide in this case whether, and in what circumstances, a fee for such legal services might be given priority over a federal tax lien.

Second, the services which the attorneys for Pioneer performed in the foreclosure proceedings were all rendered at the behest of, and for the benefit of, their client, the mortgagee, in order to protect its financial interest in the property, which was adverse to that of the United States. Indeed, the United States participated in the proceedings through its own attorney, in order to protect its interests. Hence there is no reason why an exception to the choate lien doctrine should be made in favor of mortgagees seeking priority for attorney's fees incurred in foreclosing on their security interest.

The Supreme Court of Arkansas noted (R. 76) that the United States had conceded that Pioneer has priority for its full debt and interest, and it stated (*ibid.*) that "[u]nless Pioneer gets its attorney's fee, it will not receive its full debt and interest, because the attorney's fee will have to be paid by Pioneer out of its debt and interest." This Court, however, recently rejected a similar argument in holding that a State cannot give local real estate taxes priority over a federal tax lien by treating them as expenses of sale incurred in the foreclosure of a mortgage which was concededly senior to the federal lien. *United States* v. *Buffalo Savings Bank*, No. 96, this Term, decided January 7, 1963. In that case the New York Court of Appeals, in granting the local liens priority, had reasoned as follows (*Buffalo Savings Bank* v. *Victory, et al.*, 11 N.Y. 2d 31, 39–40, 181 N.E. 2d 413, 416–417, citations omitted):

> Under New York law no funds are deemed surplus until the expenses of the sale, the costs of

> the action and the amount of the foreclosed mortgage debt plus interest have been fully paid. The procedure in this State requires the officer conducting the foreclosure sale to pay out of the proceeds all taxes, assessments and water rates which are liens on the property, unless the judgment directs otherwise. These payments are expenses of the sale by statute. * * *

In its brief in this Court the mortgagee argued that it was merely seeking "the unpaid balance of the original principal sum of its mortgage" (Brief of *Buffalo Savings Bank*, No. 96, this Term, p. 21).

This Court reversed on the authority of *United States* v. *New Britain*, 347 U.S. 81. *New Britain*, it stated, "quite clearly held that federal tax liens have priority over subsequently accruing liens for local real estate taxes, even though the burden of the local taxes in the event of a shortage would fall upon the mortgagee whose claim under state law is subordinate to local tax liens"; and it held that "the state may not avoid the priority rules of the federal tax lien by the formalistic device of characterizing subsequently accruing local liens as expenses of sale."

Thus, in *Buffalo Savings* the fact that granting the federal lien priority over local taxes would reduce the amount realized by the mortgagee on its secured claim did not justify giving the junior local liens priority over the federal lien. By similar reasoning, the priority of the federal tax lien over the attorney's fee cannot be defeated by the fact that, if such priority is recognized, the mortgagee will have to bear the legal expenses of realizing on its security.

## CONCLUSION

The judgment of the Supreme Court of Arkansas should be reversed and the case remanded with a direction to award priority to the federal tax liens over the claim for an attorney's fee.

Respectfully submitted.

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FEBRUARY 1963.

## APPENDIX A

*United States v. Pioneer American Ins. Co.*

* * * * *

CARLETON HARRIS, Chief Justice (Dissenting Opinion). I cannot agree with the Majority opinion, for I am unable to distinguished the facts in the case at bar from those in *U.S. v. Bond*, 279 F. 2d 837 (C.A. 4th), and *In re New Haven Clock & Watch Co.*, 253 F. 2d 577 (C.A. 2nd). I do not consider that discussion of those cases is necessary, for brief quotations from the opinions will suffice to explain my views. In *Bond*, the court said:

> For the same reasons, we must subordinate to priority of the federal tax liens the claim for an attorney fee paid by Perpetual in protection of the lien of its mortgage. The fee was incurred long after the attachment of the federal tax lien; and at the time of the execution of the mortgage and the creation of the debt secured thereby, the future existence or amount of such attorney fee, was, at best, speculative and uncertain.

In *New Haven*, that court said:

> The Bank sought an order in the District Court including an award of reasonable attorney's fees because the Clock Company, in the assignment contract, agreed "to reimburse the Bank for any and all legal and other expenses incurred in and about the checking, handling and collection of the accounts hereby assigned to the Bank and the preparation and enforcement of any agreement relating thereto." The Government, in its oral argument before this Court and in its brief, opposed this claim on the

> ground that the United States, acting pursuant to Sections 3670 and 3671 of the Internal Revenue Code of 1939, and Sections 6321 and 6322 of the Internal Revenue Code of 1954, 26 U.S.C. §§ 6321, 6322, had a tax lien on the proceeds of the assigned accounts which was prior to the "in choate" lien of the Bank. Since the amount of the Bank's lien for attorney's fees was unknown at the time of the Clock Company's petition for reorganization, this lien was "inchoate" in the sense used to determine its priority as against a United States tax lien. *United States v. City of New Britain*, 347 U.S. 81, 84, 74 S. Ct. 367, 98 L. Ed. 520. Thus, the Government's lien is superior to the claim for attorney's fees if the United States has complied with the aforementioned provisions of the Internal Revenue Codes and in addition has filed the notice of the lien as required * * *.

Here, there is no dispute that the lien was properly filed and recorded.

The Majority apparently depend in large measure upon the fact that our statute provides that a reasonable attorney's fee is enforceable as a contract of indemnity. In my view, this provision lends no weight to the position taken by the Majority. The sole question here is *when* the insurance company's lien for attorneys' fees came into existence, *i.e.*, did the attorneys' fee become choate before the Government filed its lien claim? There was a default on the note in October, 1960,[1] and the Majority state:

> * * * the holder of the note, immediately upon such default, became entitled to enforce the contract of indemnity; and all of this was prior to any lien filed by the United States Government. So we are definitely of the opin-

[1] The first two federal tax liens were recorded in November, 1960, and January of 1961.

> ion that the right for attorney's fee became choate before the United States Government filed its lien claim.

The question, in my view, is not when the company became entitled to enforce the provision for an attorney's fee, but rather, when it actually did enforce it. I emphatically disagree with the statement of the Majority, for I cannot see that the company was due to add the attorney's fee *immediately upon default.* Debtors frequently are a few days late in making payments, but no one would contend that this permits a note holder to add an attorney's fee. The default in payments on this note occurred in October, but I daresay that if Rogers had subsequently made the October payment, and the other payments, no foreclosure suit would have been filed. Certainly, if delinquent payments had been made and accepted by the company, it would not be contended that Pioneer should be permitted to add an attorney's fee. In such event, there would have been no occasion to enforce any contract for indemnity, for there would have been no loss.

While the default occurred in October, 1960, *the foreclosure suit was not filed until March 24, 1961.* The claim for attorney's fee can only be enforced by court action, and though I am primarily of the opinion that an attorney's fee would not have priority over the Government's tax liens until it had been definitely fixed by the court, (prior to the recording of the liens) still, if that be error, then certainly I can see no possible priority for the attorney's fee until a suit is filed asking for the fee. Both the filing of the complaint, and the order fixing the fee, occurred after the recording of the federal tax liens. The note provides:

> The undersigned also agree(s) that in the event of default herein and of the placing of

> this note in the hands of an attorney for collection, or this note is collected through any court proceedings, to pay a reasonable attorney's fee.

Our statute, quoted by the Majority, also provides that the attorney's fee is enforceable "for services actually rendered." Therefore, under the language of both the note and the statute, *a default in payment is not sufficient to enable the note holder to add an attorney's fee;* services actually rendered by an attorney (generally the filing of a suit) are necessary. But, if it be said that an attorney could render service in trying to collect payments on the note before actually instituting any suit, I point out that this record is silent as to *when* this matter was placed in the hands of the attorneys for Pioneer. *There is no evidence that appellee's attorneys rendered any service relative to collection of the note prior to the filing of the foreclosure complaint.*

The Majority state that to allow the Government to recover the amount sought would "violate the rules against unjust enrichment." I personally find no merit in this contention. The Government has its attorneys, and I am quite sure, would have been only too glad to have brought its own proceeding for sale of the property to satisfy the tax liens if such action would have given it priority over appellee.

While I have commented to some extent relative to statements in the Majority opinion, this dissent is primarily based on the holdings in the *Bond* and *New Haven* cases, a reading of which persuades me that the lien for attorneys' fee did not become choate until a definite, fixed amount was allowed by the court. As previously stated, this, of course, was long after the recording of the federal tax liens.

I accordingly feel that the Government should prevail in its contention, and respectfully dissent.

## APPENDIX B

Internal Revenue Code of 1954:

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U.S.C., 1958 ed., Sec. 6321.)

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

(26 U.S.C., 1958 ed., Sec. 6322.)

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS

(a) *Invalidity of Lien Without Notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under state or territorial laws.*—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the

State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) *With clerk of District Court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; * * *

* * * * * *

(26 U.S.C., 1958 ed., Sec. 6323.)

6A Arkansas Statutes, Annotated (1947 ed., 1957 Replacement):

68–101. *Requirements for negotiability.*—An instrument to be negotiable must conform to the following requirements:

(1) It must be in writing and signed by the maker or drawer;

(2) Must contain an unconditional promise or order to pay a sum certain in money;

(3) Must be payable on demand, or at a fixed or determinable future time;

(4) Must be payable to order or to bearer; and

(5) Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty.

68–102. *Sum certain—Definition.*—The sum payable is a sum certain within the meaning of the Act, although it is to be paid:

(1) With interest; or

(2) By stated instalments; or,

(3) By stated instalments, with a provision that upon default in payment of any instalment or of interest, the whole shall become due; or,

(4) With exchange, whether at a fixed rate or at the current rate; or,

(5) With costs of collection or any attorney's fee, in case payment shall not be made at maturity.

68–910. *Attorney's fee—Provision enforceable.*—A provision in a promissory note for the payment of reasonable attorneys' fees, not to exceed ten per cent [10%] of the amount of principal due, plus accrued interest, for services actually rendered in accordance with its terms is enforceable as a contract of indemnity.

# APPENDIX C

IN THE SUPREME COURT OF THE STATE OF ARKANSAS

UNITED STATES OF AMERICA, APPELLANT

*vs.*

PIONEER AMERICAN INSURANCE COMPANY, APPELLEE

Appeal from Sebastian Chancery Court, Fort Smith District

SUPERSEDEAS BOND

WHEREAS, the Appellant, United States of America, has taken an appeal from the Judgment of the Chancery Court of Sebastian County, Arkansas, Fort Smith Division, rendered on November 9, 1961, in favor of Appellee adjudging attorneys' fee in the sum of $1250.00 prior to the lien of the Appellant upon the property sold pursuant to said Judgment, and

WHEREAS, costs heretofore assessed in the Trial Court and other prior liens have been paid from the proceeds of said sale, and there now remains in the custody and control of the Trial Court the sum of $3,822.38, of which the sum of $2,572.38 pursuant to said Judgment of November 9, 1961, are funds of said Appellant, United States of America, and

WHEREAS, the Appellant, United States of America, now desires to supersede said judgment,

NOW THE UNITED STATES OF AMERICA and NATIONAL SURETY CORPORATION as surety hereby covenant with the Appellee that said Appellant will pay to Appellee

all costs and damages that may be adjudged against Appellant on appeal, or in the event of the failure of the Appellant to prosecute said appeal to final judgment in the Supreme Court, or if said appeal for any cause shall be dismissed that said surety shall pay to the Appellee all costs and damages and shall perform the Judgment of the Court appealed from; also that said appeal shall be perfected without delay; also, that he will satisfy and perform any Judgment or Order which the Supreme Court may render or order to be rendered by an inferior Court not exceeding $1250.00, costs of appeal, interest and damages for delay.

WITNESS our hands this 31st day of January, 1962.

UNITED STATES OF AMERICA.
CHARLES M. CONWAY,
*United States Attorney.*
By [S] Robert E. Johnson,
ROBERT E. JOHNSON,
*Assistant U.S. Attorney.*
NATIONAL SURETY CORPORATION.
By CARNALL WHEELER.

[SEAL]

Approved:
[S] Hugh M. Bland,
HUGH M. BLAND,
*Chancellor.*

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